

Institutional moral hazard in the multi-tiered regulation of unemployment in Germany – Background paper.

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Abstract

This paper has been written in preparation of a research project funded by the European Commission (on the Feasibility and Added Value of a European Unemployment Benefit Scheme, contract VC/2015/0006). This paper adds information and detailed analysis to the following deliverable of that research project: *Institutional Moral Hazard in the Multi-tiered Regulation of Unemployment and Social Assistance Benefits and Activation - A summary of eight country case studies*; but it was not a deliverable. We use the concept ‘institutional moral hazard’ to analyse intergovernmental relations within multi-tiered welfare states, specifically in the domain of unemployment-related benefits and related activation policies (the ‘regulation of unemployment’). This paper is one of eight separate case studies, it focuses on Germany. Responsibilities in the German regulation of unemployment are divided between the federal government, the federal Public Employment Services (PES) and the local level – with a supervisory role for the regional level. The German system is relatively centralised as a result of reforms aimed at mitigating institutional moral hazard and increasing divergence between activation of unemployment insurance and social assistance caseloads. Specifically, these reforms created a new social assistance scheme, more tightly regulated by the federal government, and placed activation responsibilities within one-stop-shops operated jointly by the PES and municipalities.

Keywords: *Institutional moral hazard; multi-tiered welfare states; intergovernmental relations; unemployment insurance; social assistance; Active Labour Market Policies; activation; social policy; Germany.*

Germany¹

List of Abbreviations

ALG I – *Arbeitslosenversicherung* but often referred to as *Arbeitslosengeld I* (unemployment insurance)
ALG II – *Grundsicherung für Arbeitsuchende* but often referred to as *Arbeitslosengeld II* (social assistance)
ARGE – *Arbeitsgemeinschaften* (pre-reform joint one-stop shops; despite reforms, the current *Gemeinsame Einrichtungen* are still often referred to as ARGE)
BA – *Bundesagentur für Arbeit* (federal PES)
BMAS – *Bundesministerium für Arbeit und Soziales* (German Federal Ministry of Labour and Social Affairs)
PES – Public Employment Services
SA – Social Assistance
SGB II – *Zweites Sozialgesetzbuch* (legislation governing ALG II)
SGB III – *Drittes Sozialgesetzbuch* (legislation governing ALG I)
UI – Unemployment Insurance

Introduction

Germany is a federation in which the regulation of unemployment is relatively centralised. However, this has not always been the case. German unemployment regulation involves several important actors: the federal government, the semi-independent federal PES (*Bundesagentur für Arbeit* or BA), the municipalities and the regions. Heterogeneity in activation practices and instances of institutional moral hazard were among the contributing factors leading up to the Hartz IV reforms.

The German experience with institutional moral hazard and the reforms that followed make Germany an interesting case. Before the 2002-2005 reforms, Germany had multiple employment-related benefit schemes that were administered by different levels of government. More importantly, the activation of those benefits rested in the hands of different levels of government. This institutional set-up is akin to that of Switzerland and Austria. In the face of similar challenges (a dichotomy between activation of SA and UI and heterogeneity in SA activation performance), Germany opted for a more centralised system in which unemployment assistance and social assistance (SA) were combined (into *Grundsicherung für Arbeitsuchende* but often referred to as *Arbeitslosengeld II* or ALG II). This new benefit scheme became centrally regulated and financed. The changes to the institutional set-up of unemployment insurance (UI) were relatively modest, as it remained fully centralised.

The governance of activation of beneficiaries of the new SA system underwent several changes. The Hartz reforms introduced joint one-stop shops in which the central PES and the local authorities operated side-by-side. It is this system of joint consortia that has been the subject of subsequent reforms. The issues that arose were constitutional but also practical in nature. A unique feature of the German model is a parallel system of one-stop shops in municipalities that have opted out of the centralised system. Starting out as a policy experiment, these so-called *Optionskommunen* have since become embedded in federal legislation, thereby creating three types of one-stop shops that

¹ We thank Regina Konle-Seidl and Werner Eichhorst for very useful exchanges on the German case and Regina Konle-Seidl for extensive comments on our drafts.

perform activation services: the central PES offices for UI, and the joint consortia and the *Optionskommunen* for SA. Notwithstanding this parallel system, it could be argued that the German system has become the most centralised of all the federal cases.

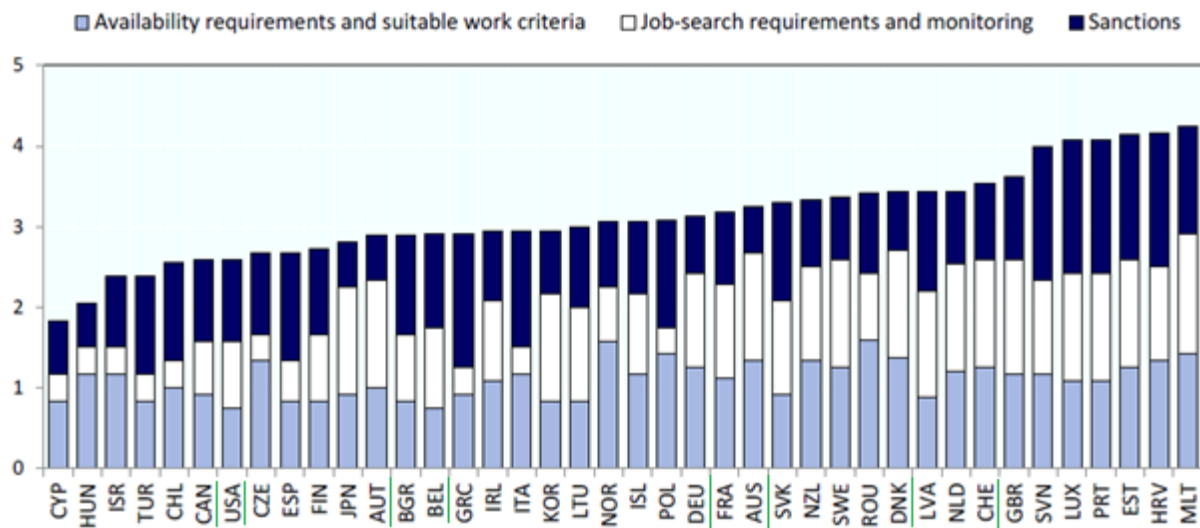
As explained in the synthesis report of our research project, we make a distinction between ‘institutional moral hazard’ and ‘principal agent problems’. We use the expression ‘institutional moral hazard’ for situations in which two levels of government and political constituencies are involved; if the actors involved at the lower level do not have a political nature, we refer to principal-agent problems. Our use of the concept ‘principal-agent relation’ can be questioned in the case of an institution such as the German federal PES, the *Bundesagentur für Arbeit* (BA): the German BA is not an ‘agent’ of the federal government, but a self-governing institution, and social partners also have a role as ‘principal’ in the BA, if the ‘principal-agent’ terminology is used. We recognize the validity of that criticism²; it is corroborated by a typology developed by Mabbett and Bolderson, who argue that multi-level governance prevails in the relationships between central governments and administering institutions in social security, rather than simple principal-agent relations (Mabbett and Bolderson, 1998). Nevertheless, in the context of this research project, we want to maintain a simple distinction between relationships between political actors and relationships involving non-political actors (including in the latter, institutions for which social partners are to some extent ‘principals’). In follow-up research we will return to this question.

² We are indebted to Regina Konle-Seidl for this point.

1. Unemployment insurance

The current German UI (*Arbeitslosenversicherung I* or ALG I) is a benefit scheme that is fully federally legislated, financed and implemented. Its replacement rates vary between 60% and 67% of the previous net wage – depending on whether or not the beneficiary has children.³ The maximum duration is two years.⁴ Jobless workers who are able, available and actively seeking employment and have been insured for a minimum of twelve months within a two-year period are eligible for this scheme.⁵ The strictness of eligibility criteria is average compared to other OECD countries (see Figure 1). There are several reasons for this; on one hand, there are comparatively strict availability requirements, suitable work criteria, job search requirements and monitoring. On the other hand, there is a relatively relaxed sanctioning regime (see Figure 2).

Figure 1 Overall strictness of eligibility criteria. Source: Langenbucher 2015, p. 27.

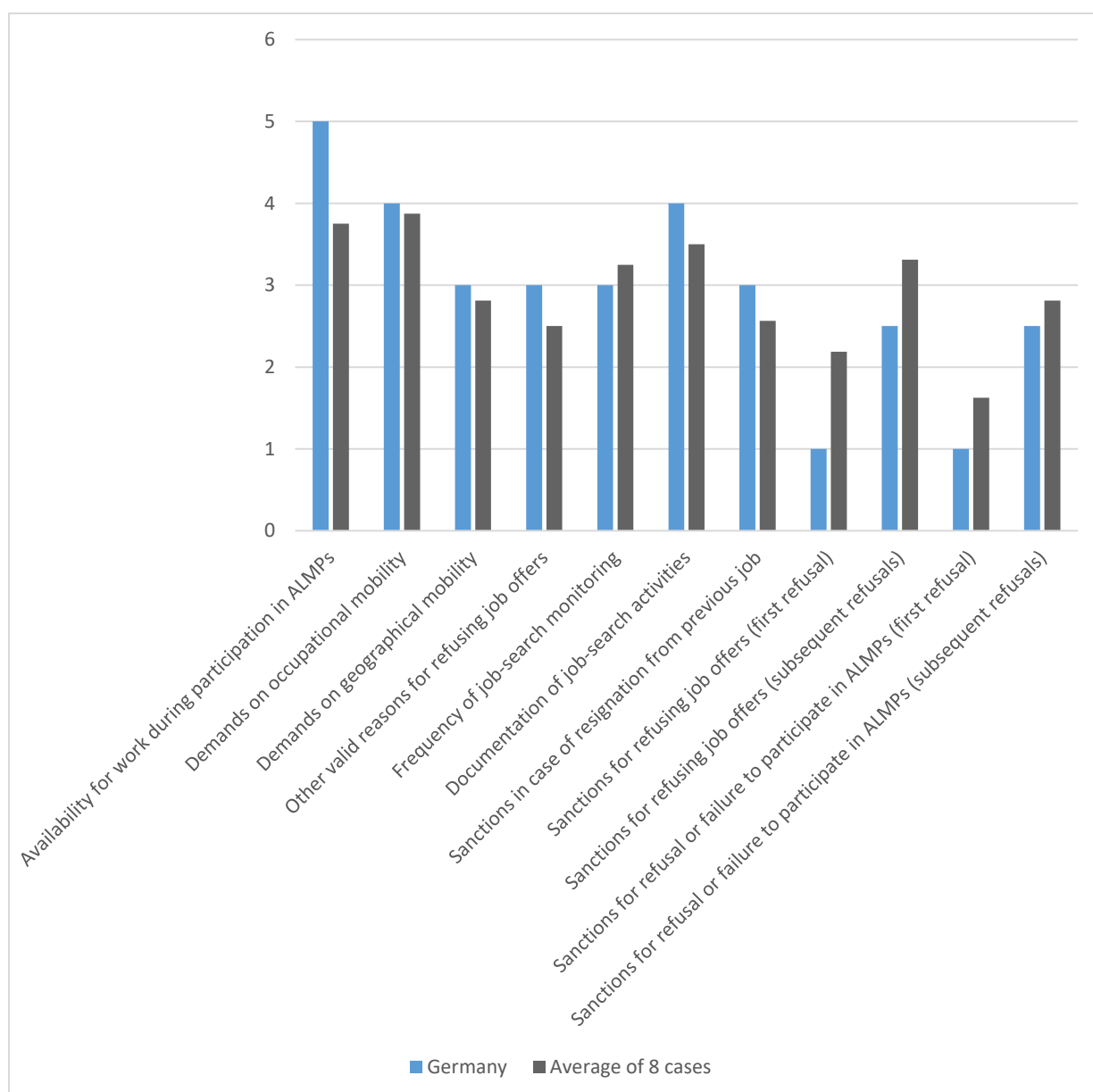


³ See paragraphs 89, 129, 149-154 and 118-121 of the SGB III.

⁴ See paragraphs 147-148 of the SGB III.

⁵ See paragraphs 155-160 of the SGB III.

Figure 2 Strictness of eligibility in German UI. Source: Langenbucher 2015.



ALG I is a scheme fully financed and implemented at the federal level, and is codified in the federal *Drittes Sozialgesetzbuch* (SGB III). It is financed by employer and employee contributions.⁶ The administration and disbursement is in the hands of the BA, which operates out of 178 local offices with over 773 branches overseen by 10 regional directorates. Much like its Austrian counterpart, the BA is an at-arm's-length self-governing agency which is overseen by the federal ministry.⁷ The responsibility for operations lies with the management board (*Vorstand*), which is overseen and monitored by a tripartite supervisory board (*Verwaltungsrat*). Management committees supervise

⁶ See [paragraphs 341-349 of the SGB III](#) for regulations on the amounts of contributions, how they are collected and when they are paid. [Paragraphs 363-365 of the SGB III](#) determine that the funding of the BA comes from the federal level; any deficit the BA may experience is also covered by the federal level (Ebbinghaus, 2007, pp. 35-36).

⁷ See [sections 2 and 3 of chapter 11 of the SGB III](#).

local offices and can inform the supervisory board in case of misconduct.⁸ This benefit scheme and its governance have been left relatively untouched by the Hartz reforms. However, since the federal level has sole legislative authority over ALG I and because the BA has no meaningful policy autonomy in determining any of the parameters of this benefit, we regard this benefit scheme *sensu stricto* as neither decentralised nor delegated in the context of our analytical grid.

As becomes clear from Table 1, there are clear and structural differences in the unemployment rates across the *Länder*. Unfortunately, data on the caseloads of the different one-stop-shops per municipality and per region are not readily available. However, the structural heterogeneity in unemployment rates is quite large, making it very probable that there are indeed structural differences in the size of the ALG I and ALG II caseloads. Since both ALG I and ALG II are federally financed, this entails a structural redistribution.

Table 1 Heterogeneity in German regional unemployment rates. Source: EU Labour Force Survey, unemployment rates by NUTS 2 regions, own calculations.

	1999	2000	2001	2002	2003	2004	2005	2006
Average	10,9	10,1	9,98	10,7	11,9	13,1	13,5	12,3
Standard deviation	4,92	5,05	5,6	5,32	5,26	5,6	4,94	4,43
Coefficient of variation	45,2	50,1	56,1	49,5	44,1	42,8	36,6	36,1
	2007	2008	2009	2010	2011	2012	2013	2014
Average	10,5	9,08	9,07	8,16	6,91	6,45	6,16	5,91
Standard deviation	4,09	3,6	3,03	2,65	2,44	2,33	2,21	2,05
Coefficient of variation	39	39,6	33,4	32,5	35,3	36,2	35,8	34,7

⁸ See [paragraph 374 of the SGB III](#).

2. Social assistance

Contrary to the ALG I benefit scheme, SA has been overhauled by the Hartz reforms. The current labour market-related SA scheme was created by combining the former unemployment assistance (*Arbeitslosenhilfe*) and the SA (*Sozialhilfe*) schemes. *Arbeitslosenhilfe* was akin to the Austrian and Swiss unemployment assistance schemes in the sense that it was somewhat less generous than regular UI, and it was income-related, but means-tested beneficiaries aimed at those beneficiaries who exhausted their UI claim (Konle-Seidl, 2008, p. 8). Furthermore, it was of indefinite duration – as the Austrian UA still is. Like the Austrian unemployment assistance scheme, *Arbeitslosenhilfe* used to be administered by the central PES, which also administered the UI scheme. *Sozialhilfe* was an indefinite residual flat-rate and means-tested scheme for persons without a formal connection to the labour market, and it was operated by the municipalities.

The burden of SA was very unevenly divided, the heterogeneity in caseloads putting budgetary pressure on municipalities with large caseloads. Furthermore, those municipalities were less able to provide meaningful activation, for which they were also responsible (Knuth & Larsen, 2010). Disparities, existing between the municipalities as well as between the regimes for those having a formal labour market link and those on *Sozialhilfe*, became a growing concern for the German federal government. The response – which was part of the Hartz reforms – was to combine the two aforementioned benefit schemes into a single one (*Grundsicherung für Arbeitsuchende*, but often referred to as *Arbeitslosengeld II* or ALG II), codified by a single federal law: *Zweites Sozialgesetzbuch* (SGB II). After this merger, only a small part of the old *Sozialhilfe* – with regard to persons unable to work – remained the responsibility of the municipalities. Responsibility for dispersing benefits was transferred to the BA and the activation became the responsibility of one-stop shops, where the BA and the municipalities operated together (cf. *infra* for a more detailed discussion and a precise description of the division of labour within those one-stop shops).

Because part of the caseload of the old *Sozialhilfe* – those who were unable to work – was to remain under municipal responsibility, the entire caseload had to be screened in order to assess working capacity. Municipalities themselves had to conduct this assessment, which led to the (morally hazardous) situation where municipalities were in charge of determining to which budget the old *Sozialhilfe* caseload was transferred. This led to the moral hazard of municipalities classifying workers who are in fact unable to work as ‘capable of working’, a practice that existed for some time (Eichhorst, Grienberger-Zingerle, & Konle-Seidl, 2008, p. 47). Deeming someone capable of working would in effect transfer that individual from the municipal budget to the federal budget; consequently, 90% of the old *Sozialhilfe* claimants were assessed as capable of working (Eichhorst, Grienberger-Zingerle, & Konle-Seidl, 2006, p. 23).

The new setup of SA after the combination of two benefits into one meant that SA has been (almost) completely federalised. The federal government has become responsible for the legislation of ALG II. It is a means-tested and flat-rate benefit, and, in principle, of indefinite duration.⁹ The rates are

⁹ The benefit is contingent on an integration agreement between the beneficiary and the activating institution, which lasts for six months and must then be renewed in order to prolong benefit eligibility. See [paragraph 15 of the SGB II](#).

shown in Table 2; however, they do not yet include supplements for additional needs such as housing and heating, which are an integral part of the benefit.¹⁰ The old *Sozialhilfe* benefit was jointly financed by the municipalities (75%) and the Länder (25%).¹¹ For ALG II, the division is radically different and involves different actors. The federal government finances the benefits, administration, activation, and a minor part of the housing and heating costs.¹² The municipalities contribute the larger part of the housing and heating supplements, which amounts to around 20 to 25% of the total costs. In other words, the federal government has become the most important source of funding and the municipalities have taken a back seat in this regard. The funding for this benefit (and its activation regime) comes from general tax revenue rather than from social contributions – as is the case for ALG I.¹³ The administration and disbursement is in the hands of local one-stop shops, which are jointly run by the BA and the municipalities (cf. *infra*).¹⁴

Table 2 ALG II flat-rate ('Regelsatz') benefits (excluding supplements). Source: [website of German federal government](#).

	Until 31.12.2015	from 01.01.2016
Single persons	399 €	404 €
Partner and kids > 25y living in the same household	360 €	364 €
kids > 25 Y living in a separate household	320 €	324 €
kids 0-6 Y	234 €*	237 €*
kids 6-14 Y	267 €*	270 €*
kids 14-18 Y	302 €*	306 €*

The structural heterogeneity in unemployment rate, as measured by the coefficient of variation in Table 1, continues its downward trend after the introduction of the Hartz reforms. It is difficult to say whether this is due to the reclassification of *Sozialhilfe* and the former unemployment assistance scheme, the harmonisation effects of the Hartz reforms or due to other factors. This development could be interpreted as a result of changes in the regulation of unemployment because the poorer (and poorer performing) municipalities now have one-stop shops, which are mostly financed by the federal government, meaning more resources would most likely be spent on activation within those municipalities. However, the downward trend sets in before the reforms (which took place in 2004).

¹⁰ See [paragraphs 20-22 of the SGB II](#).

¹¹ According to MISSOC comparative database for Germany (2004-05-01) [checked: 26-06-2015].

¹² See [paragraph 46 of the SGB II](#).

¹³ See [paragraph 46 of the SGB II](#).

¹⁴ 'Local' in the German context refers to the district (*Landkreise*) level. Officially, this level is one step above the municipal level, but a good amount of literature on ALG II and activation thereof speaks of the municipal level. We therefore also refer to *Landkreise* as municipalities.

3. Activation

The BA is the most important actor in activating both the UI and SA caseloads. However, there is a different regime for both caseloads, which stems from the previous split between the former UI and assistance on one hand and the old *Sozialhilfe* on the other hand. As already mentioned, the Hartz reforms combined the majority of the *Sozialhilfe* and the unemployment assistance caseload. It also entailed that this new ALG II caseload was subsumed under one single activation regime. Ironically, it was political upheaval surrounding the PES that triggered the Hartz reforms (Eichhorst, Grienberger-Zingerle, & Konle-Seidl, 2006, p. 11). The old PES was a tripartite organisation, much like the renewed Austrian AMS currently is. It was found to intentionally misrepresent placement figures and thereby overstate their performance.

Before the turmoil surrounding the PES, the Red-Green coalition government was divided on how to tackle the growing – and already strong – segmentation between long-term and short-term unemployed. Divisions arose over the role of decentralisation; there were some forces pushing for greater decentralisation and others for more decentralisation. Federal concerns were threefold: municipalities were responsible for the activation of beneficiaries of the old *Sozialhilfe*, but did not implement activation services systematically. This led to a situation in which there were municipalities that implemented activation intensively and successfully as well as municipalities that did not activate effectively. In essence, this entailed that there were not only disparities between the regime of *Sozialhilfe* and UI and UA, but also between municipalities themselves (Budapest Institute, 2015, p. 44). The third dimension of the problem is even more poignant given the subject of moral hazard. Many local authorities placed SA beneficiaries in work programmes that renewed their eligibility for UI, effectively dumping their caseload into federally-financed benefits (Eichhorst, Grienberger-Zingerle, & Konle-Seidl, 2006, p. 7; Budapest Institute, 2015, p. 44). The political upheaval concern the PES broke the stalemate in the coalition on decentralisation and paved the way for the Hartz reforms (Eichhorst, Grienberger-Zingerle, & Konle-Seidl, 2006, p. 11). The decentralisation effort that was part of the Hartz reform included several compromises on devolution. On one hand, the activation of ALG II was devolved to one-stop shops that were run by both the municipalities and the BA, while on the other hand, several municipalities were given the choice to opt out of this system of joint one-stop shops and run their own one-stop shop (cf. infra).

The Hartz reforms did not just overhaul the benefit system, but also reorganised the PES with a stronger role for the federal government. This can be seen as a direct response to the principal-agent issues that led to the turmoil surrounding the PES; the PES was too autonomous and the federal government had too few tools to effectively monitor it. Substantively, the BA was reorganised along New Public Management lines (Budapest Institute, 2015, p. 95) to give the federal government more tools to combat principal-agent issues. However, the division of labour concerning the activation of UI beneficiaries remained relatively unchanged: the PES remained the primary responsible actor in the disbursement and activation of ALG I. Furthermore, the federal government remained responsible for the design of the system. ALG I and the activation of its beneficiaries also continued to be financed by employer and employee contributions. As already noted, the new BA was charged with the activation of the ALG II benefit along with local authorities. This was to be implemented through the aforementioned joint one-stop shops (or sometimes referred to as joint consortia).

So for the activation of ALG I, the BA acts as a semi-independent body of public law. Despite its self-governing nature (in *casu* for ALG I), we still regard the relationship between the BA and the federal government as one of 'delegation' with regard to activation.¹⁵ For the activation of ALG II, the BA acts as a contracted agent on behalf of the federal government, working in tandem with the local authorities in joint consortia. The main difference in practice, is the intrusive nature of federal oversight. Furthermore, in contrast to ALG I, the ALG II regime (both its benefits *and* the activation of its beneficiaries) is tax-financed.

Within the municipalities that opted out of the joint system with the BA, the localities would regain full responsibility over their local one-stop shop and, therefore, retain responsibility over activation of SA beneficiaries. The next sections will develop these different regimes and the implications for the relationship between the BA and the levels of government more thoroughly.

¹⁵ Cf. the *caveat* w.r.t. the application of the principal-agent concept formulated at the end of the introduction of this case study.

4. Activation of unemployment insurance

The BA implements the activation of ALG from 178 local offices with over 770 branches. For the purposes of activation of ALG I beneficiaries, the BA operates as determined by the SGB III. This entails that it is a self-governing agency, which enacts its own statutes and is governed by the aforementioned boards but is supervised by the Federal Ministry of Labour and Social Affairs. In practice, the BA still holds much autonomy. The federal level influences the design of policies through the SGB III and has official judicial oversight over the BA, but otherwise has little tools to influence the operations of the BA.¹⁶ The BA itself has a strict hierarchal structure, with the headquarters at the top, the regional directorates as a transmission belt and the local offices at the bottom.

The most important point of influence of the federal government is that it dictates which types of services are to be delivered by the BA (see Table 3). Furthermore, for some services the SGB III stipulates eligibility criteria. However, the implementation of the services is almost completely left to the discretion of the BA.¹⁷ Their services are financed through the same source of revenue as the ALG I benefits: social contributions.¹⁸

Table 3 Services to be provided by the BA. Source: Chapters 3-4 of the SGB III.

Counselling and placement	Advisory services
	Vocational guidance
	Career orientation
	Labour market consultancy
Mediation	Mediation offer
	Integration agreement
Vocational integration and training	Services to facilitate transition from school to vocational training
	Vocational preparation (pre-employment training)
	Vocational training aid
	(Contribution to) traineeships
	Retraining
Various	Transition allowance
	Promotion of self-employment
	Short working time allowance (Kurzarbeit)
	Mini- and midi-jobs

There is no federally-prescribed system of minimal interventions or minimum requirements such as, for example, in Australia. Rather, the federal government has codified the responsibilities of individuals, which include reporting to the BA.¹⁹ So there is somewhat of a federal regulation regarding the timing and substance of contact between the BA and the unemployed who are insured, but this is regulated from the individual's point of view.

¹⁶ Judicial oversight in this sense entails that the ministry is responsible for monitoring whether the BA keeps to its statutes of governance which are enacted by the *Verwaltungsrat*. It does not entail any functional influence or oversight as it does concerning the ALG II (cf. infra).

¹⁷ See [paragraph 3 of the SGB III](#).

¹⁸ See [the financing chapter of the SGB III](#).

¹⁹ See [chapters 8-9 of the SGB III](#).

5. Activation of social assistance

Before the Hartz reforms, the local level was almost completely responsible for *Sozialhilfe*, including activation of its beneficiaries. As said, this led to some instances of moral hazard in the form of dumping – through the renewal of UI eligibility by way of work programmes. The joint one-stop shops or consortia enacted by the Hartz reforms are now called *Gemeinsame Einrichtungen*, but are still often referred to by their former name *Arbeitsgemeinschaften* (ARGEn).²⁰ The name change accompanied a reform of the consortia after the Hartz reforms. After their initial introduction, tensions arose within the ARGEn between local methods of implementation and central goals and coordination. The local level felt constrained by the monitoring and steering from the federal level. This led to a compromise: from 2006 onwards, the ARGEn would determine their operational targets themselves (Konle-Seidl, 2008, p. 16). These changes did not solve the underlying problem, which was “a clash of cultures” between the BA and the municipal employees (Eichhorst, Grienberger-Zingerle, & Konle-Seidl, 2006, p. 39; Konle-Seidl, 2008, p. 17). A ruling by the constitutional court in Karlsruhe determined that the ARGEn were unconstitutional on the basis that the federal government cannot create ‘mixed administration’ in which responsibilities of the state and the local government are intermingled because it infringes on the local right to self-rule (Knuth & Larsen, 2010, p. 187).²¹ This led to the transformation of the *Arbeitsgemeinschaften* into the current *Gemeinsame Einrichtungen* as well as a constitutional change that accommodated these joint consortia and the *Optionskommunen*. Instead of federal control and monitoring directly within local agencies, the *Länder* were now placed in between the local agencies and the federal level: “The new legislation gives the national government the powers to supervise the *Länder* authorities, which, in turn, are supervising the proceedings of the municipalities. Target agreements binding the licensed municipalities will be achieved in a similar two-tier process” (Knuth & Larsen, 2010, p. 17).

So the current governance of the consortia is as follows. An assembly of representatives from the local authorities and the BA (the *Trägerversammlung*) appoints a managing director, decides on procedural rules and sets guidelines for the managers of the consortium.²² In essence, the consortia are “servants to two masters” since the local authorities and the BA are equally represented in the assembly (Jantz & Jann, 2013, p. 242). The BA and the local authorities are, in turn, supervised by the ministry and the competent *Länder* authorities, respectively.²³

Within the joint one-stop shops, the default division of tasks is the following: the BA handles the ALG II benefits *sensu stricto* as well as the activation services. The local authorities are responsible for additional social services rendered to the beneficiaries. These include addiction counselling, psychosocial care and debt counselling.²⁴ The localities that have opted out of this system are subject to a slightly different regime. Initially, there were 69 so-called *Optionskommunen* (officially *zugelassenen kommunalen Träger*), which could apply for this status through a complicated

²⁰ See [paragraph 44b of the SGB II](#) for the current description of responsibilities.

²¹ *Bundesverfassungsgericht*, decision of 20/12/2007

²² See [paragraph 44c of the SGB II](#).

²³ The introduction of the *Länder* authorities to supervise the local authorities being the key element in the reform of the ARGEn. See [paragraph 47 of the SGB II](#).

²⁴ See [paragraph 16a of the SGB II](#).

procedure (Aarts, 2015, p. 21). This number has since expanded to 110 due to the fact that this policy experiment was only formally adopted in the SGB II after the aforementioned constitutional change that allowed for the existence of the *Optionskommunen*.²⁵ These locally run one-stop shops have no joint assembly; rather, they are completely supervised by the competent *Länder* authorities.²⁶ Within these one-stop shops, the local authorities are responsible for all activities and services.

The federal level is financially responsible for all of the activation costs made by the consortia – including the *Optionskommunen*.²⁷ The local authorities are responsible for financing a part of the heating and housing supplements and for the additional social services. The whole system is federally legislated. The federal influence extends to the legislation of mandatory integration agreements, which the one-stop shops have to enter into with their clients, and a description of services and eligibility requirements.²⁸ Within the one-stop shops, the partners can administer the same range of services under SGB III (see Table 3).²⁹ Because the BA operates as a contracted partner, rather than the independent agency of the ALG I regime, the supervision of the one-stop shops is more regulated than the supervision of the BA offices. The next section will develop this more thoroughly.

²⁵ Their claims have to be approved by the ministry and the competent *Land*, see [paragraph 6a of the SGB II](#).

²⁶ See [paragraph 48 of the SGB II](#).

²⁷ See [paragraph 6b of the SGB II](#).

²⁸ See paragraphs [3](#), [4](#) and [15-17](#) of the SGB II.

²⁹ See [paragraph 16 of the SGB II](#).

6. Concern for institutional moral hazard & principal-agent issues

Institutional moral hazard does not play a role in the ALG I activation regime. Rather, because the BA functions as a semi-independent federal agency, we characterise the relationship as a principal-agent relation.³⁰ The political concerns about the PES drew attention to principal-agent issues concerning the BA. The lack of effective oversight and internal control measures meant that the BA offices could overstate their performance. The BA still enjoys much autonomy in how it implements the prescribed services. There is no system of minimum requirements that prescribes mandatory actions or a timetable for interventions as there is in, for example, Australia. After the Hartz reforms, however, the BA itself placed more emphasis on monitoring; before, there was no performance management system in place regarding the local or regional offices of the BA (Budapest Institute, 2015, p. 94). The federal level enacted a performance measurement system for all levels of the BA. It must be noted that there are differences in the role of the BA between ALG I and ALG II schemes. Concerning UI, the federal government has defined very broad policy goals which make up the first paragraph of the SGB III – these goals are not quantified (see Table 4).

Table 42 Policy goals of the SGB III. Source: Paragraph 1 of the SGB III.

Increase transparency on the training and labour market, support professional and regional mobility and ensure the rapid filling of vacancies
Promote individual employability through maintenance and expansion of skills, knowledge and competences
Counteract employment loss
Improve the employment situation of women, by encouraging the elimination of existing disadvantages, by overcoming gender biases in education and on the labour market and by reducing the share of unemployed women

These goals form the basis for formulating framework targets with the BA as they relate to ALG I. However, these so-called *Rahmenziele* are very general and do not include numerical targets. Furthermore, they are different from the internally-formulated BA goals, and there are no consequences attached to the performance of the BA in this regard (Christensen, Jantz, & Lægheid, 2014, p. 15). Moreover, the BA is formally not even obligated to negotiate any targets because the Ministry of Labour has no formal oversight responsibilities for operations, but only for the governance structure of the BA. This explains the relative symbolic function of the *Rahmenziele*. In fact, “senior managers of the FEA have reported that the target agreements with the BMAS have no influence on their work and sanctions for not reaching the targets are neither formulated nor applied” (Christensen, Jantz, & Lægheid, 2014a). However, the BA is obligated to carry out (and publish) research into the effectiveness of policies.³¹ The BA has an internal system of performance management. Before 2010, this was based on a hierarchical model in which the headquarters developed goals, and the regional directorates translated these goals to the regional level and negotiated the levels in cooperation with the local offices. Currently, the process is more bottom-up, with the local offices proposing their own budgets and targets that they then negotiate with the central level (Budapest Institute, 2015, pp. 98-99). Additionally, local offices now have to report monthly on several output and outcome targets and a relatively small portion of the managers’ remuneration has become contingent on the performance of the office – as is the case for the regional level (Budapest Institute, 2015, pp. 98-99). The performance measurement, the general

³⁰ Cf. the *caveat* w.r.t. the application of the principal-agent concept formulated in the introduction of this case study.

³¹ See [paragraph 282 of the SGB III](#).

goals and the financial incentives for managers can all be considered New Public Management tools to address principal-agent issues.

As a contracted partner, the BA faces a different performance regime when it comes to ALG II. Concerning ALG II, the federal government has official technical and operational oversight over the BA. The *Länder* supervise (1) the efforts of the localities in the consortia and (2) the *Optionskommunen* (cf. infra).³² As with ALG I, the first paragraph of the SGB II formulates the policy goals of the ALG II benefit (see Table 5).³³ These goals also form the basis of the (quantified) *Rahmenziele* (see Table 6).

Table 5 Policy goals of the SGB II. Source: Paragraph 1 of the SGB II.

Promote gender equality
Eliminate neediness and shorten duration of benefit dependency
Maintain or improve the earning capacity of individuals
Consider family circumstances (child-rearing)
Overcome disability and other disadvantages
Create and maintain incentives to take up and pursue economic activity
Promote labour market integration
Secure a livelihood

However, contrary to the ALG I regime, there is a quantified and more complex performance management system. There are four relationships which are governed by the performance management agreements concerning SGB II: the federal level and the BA; the assembly of the one-stop shops and the manager; the *Länder* and the *Optionskommunen*; and the federal level and the *Länder*.³⁴ The first three relationships must include performance agreements which have adopted three legislated indicators (see Table 6).

Table 6 Mandatory indicators (*Rahmenziele*) for performance management agreements. Source: Paragraph 48b (3) of the SGB II.

Reducing benefit dependency	Outcome
Improving labour market integration	Outcome
Avoiding long-term benefit dependency	Outcome

The fourth relationship is somewhat different from the others. The *Länder* and the federal level come together in a so-called Cooperation Committee (*Kooperationsausschuss*), which decides on objectives and priorities for ALG II within the *Länder*.³⁵ These objectives, however, may not interfere with or affect the targets mentioned earlier (see Table 6).

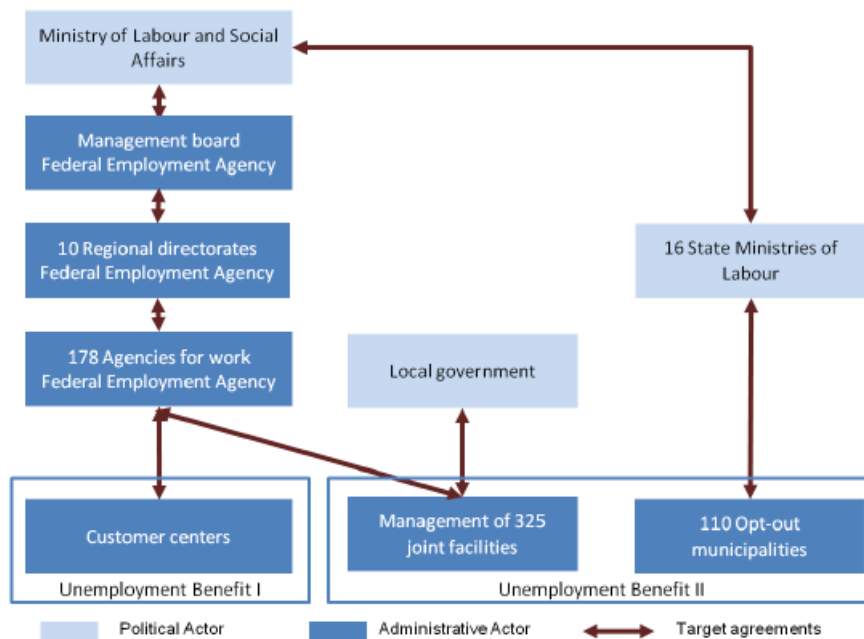
³² See paragraphs 47 and 48 of the SGB II.

³³ See [paragraph 1 of the SGB II](#).

³⁴ See [paragraph 48b of the SGB II](#). See [here](#) for all current agreements between all these actors.

³⁵ See [paragraph 18b of the SGB II](#).

Figure 1 Accountability relationships in ALG I and ALG II. Source: Christensen, Jantz & Lægreid, 2014, p. 16.



Pre-Hartz reforms, there was a clear instance of institutional moral hazard: through interaction between work programmes for *Sozialhilfe* recipients and regular UI, local authorities were able to dump their caseloads. However, apart from such instances of institutional moral hazard, the Hartz reforms were mainly instigated by the desire to provide a single gateway to the unemployed, to relieve municipalities of their (increasingly) heavy burden and to overcome the concomitant regional disparities. Furthermore, the centralisation transformed the nature of decentralisation from political to managerial. This entails that we no longer speak of institutional moral hazard but of principal-agent issues, which are associated with the relationship between (semi-independent federal) agencies, such as the BA, rather than political entities and the federal government.

The only remaining possibility for institutional moral hazard within the German system occurs within the *Optionskommunen*. This moral hazard arises out of the division of labour between two levels of government: the federal and the municipal. These municipalities operate one-stop shops themselves, largely with federal funds. The clients which are served by these municipally run one-stop shops do receive (for the major part) federally financed, designed and implemented benefits. Several studies suggest that there are structural differences in the approaches between regular joint one-stop shops and the one-stop shops within the *Optionskommunen* (Aarts, 2015; Boockmann, Thomsen, Walter, Gobel, & Huber, 2010; BMAS, 2008). The 'centralised' joint one-stop shops have a stronger focus on (and better performance in) the predetermined outcome measures (BMAS, 2008). This research indicates that there is an incongruence between the approach in the *Optionskommunen* and the federally set targets. The oversight from the *Länder* that was in place does not seem to have prevented this. These findings predate the introduction of the ALG II *Rahmenziele*. Since they are quantified, contrary to the ALG I *Rahmenziele*, it is likely that the ALG II targets will have more of an impact. However, the precise effects of the introduction of the ALG II targets is not yet clear.

Oversight of the BA in the case of ALG I is in the hands of the tripartite *Verwaltungsrat*. The *Verwaltungsrat* appoints management committees, which operate supervision at the local level and can inform the *Verwaltungsrat* in the case of misconduct. In cases of gross misconduct, the

Verwaltungsrat can enlist the help of the ministry. The oversight for ALG II is much more directly governed by both the federal and *Länder* governments. The Cooperation Committee (cf. supra) can influence the decisions of the Assemblies to appoint managers of the joint consortia, and it breaks ties in the case that the Assemblies are in disagreement.³⁶ The federal ministry has oversight over the use of federal finances, determines the distribution of funds, and can set criteria for the use of federal funds.³⁷ Furthermore, the BA plays a major role in assessing the earning capacity of individuals, and in assessing how to implement federal funds and how to implement services.³⁸ *In casu*, the federal government can directly instruct the BA on practical matters, which gives it influence over the joint one-stop shops through the BA. Finally, the federal and *Länder* governments monitor and compare the performance of the joint one-stop shops in regards to the timeliness of payments, combating fraud, etc., while the joint one-stop shops are also obligated to organise internal audits.³⁹ The *Länder* perform these tasks and the supervisory tasks of the BA for the *Optionskommunen*. Due to the direct administrative control and federal financing of ALG II, there is little use of financial incentives to improve performance at the local level.

The existence of the *Optionskommunen* is a little puzzling in this sense. In principle, the *Länder* fulfil the monitoring and governance role of the BA in these job centres. But as research has pointed out, there are structural differences in performance between the regular consortia and the *Optionskommunen*. This could be due to the difference in culture between employees of local authorities and those of the BA or due to incongruence between federal goals and desires and locally-held views. The introduction of the ALG II *Rahmenziele* may have mitigated these issues with the *Optionskommunen*.

In summary, with the Hartz reforms, the German federal government responded to three problems simultaneously: principal-agent issues concerning the BA, institutional moral hazard in activation of SA, and the dichotomy in the activation of UI and SA as well as between municipalities. The Hartz reforms can be seen partly as a centralisation effort of the SA benefit scheme and partly as a New Public Management-inspired governance reform of the federal PES. In turn, the political compromises that made the Hartz reforms possible led to new problems; the joint one-stop shops remained a source of tension between the involved actors, and the *Optionskommunen* did not perform similarly to the regular one-stop shops.

³⁶ See paragraphs 44d and 44e of the SGB II.

³⁷ See paragraphs 6b and 46 of the SGB II.

³⁸ See paragraphs 44a and 44f of the SGB II.

³⁹ See paragraphs 48a and 49 of the SGB II.

7. Analytical grid

Table 7 Analytical grid Germany. Source: own compilation.

		Unemployment benefits (ALG I)	Activation of individuals with unemployment benefits	Unemployment-related SA/ income support benefits (ALG II)	Activation of individuals with SA benefits
1	Degree of decentralisation (i.e. extent of flexibility on lower level) w.r.t. design of the policy: - Formal regulation - Policy goals	No decentralisation	Low decentralisation Federal level prescribes the design of policies and sets broad goals. The BA formulates its own internal targets.	No decentralisation	Low decentralisation
2	Degree of decentralisation (i.e. extent of flexibility on lower level) w.r.t. implementation of the policy	No decentralisation (The BA implements and administers the disbursement of benefits but has no policy autonomy concerning UI; hence, no delegation.)	Delegation to BA and high decentralisation The BA implements activation with significant leeway.	No decentralisation	Delegation to BA and medium decentralisation Within joint consortia (operated by the municipalities and the BA), the BA is responsible for activation. The leeway of the BA is more limited (compared to ALG I) due to federal monitoring and some mandatory work processes. Within the <i>Optionskommunen</i> , the activation is implemented by the municipalities themselves within the same limits as the BA.
3	Budgetary responsibility	Federal Financed by social contributions	Federal Financed by social contributions	Federal & municipalities The federal level finances the major part of the benefits (financed by taxation) while the municipalities contribute to housing & heating supplements.	Federal Financed by taxation
4	Budgetary transfers between levels of government?	n.a.	n.a.	n.a.	n.a. Except for <i>Optionskommunen</i> , which receive federal funds to

					implement activation.
5	Structural redistribution? (measured on a per capita basis)	Yes Structural differences in caseloads	Yes Structural differences in caseloads	Yes Structural differences in caseloads	Yes Structural differences in caseloads
6	Political or managerial decentralisation/delegation?	n.a.	Delegation, with managerial decentralisation to the BA The BA is an agent of the federal government.	n.a.	Delegation, with managerial decentralisation to the BA In <i>Optionskommunen</i> : political decentralisation
7	Indicators used in the monitoring of lower-level performance by higher level (on the basis of: input, output and outcome)?	n.a.	Qualitative (but not quantitative) outcome indicators	n.a.	Outcome indicators
8	Is a system of 'minimum requirements' applied?	n.a. The legislation concerning ALG I and the implementation thereof is tightly regulated at the federal level.	No	n.a.	Yes, but very limited Mandatory integration agreement
9	Are performance-based sanctions/rewards applied by the higher level at the lower level?	n.a.	No No financial incentives from the federal level to the BA. Within the BA, there are small financial bonuses for managers at the local level.	n.a.	No
10	Conclusion from 5-6-7: perception of, concern for, and approach to problems of institutional moral hazard?	n.a. There is only a single level of government involved in the governance of ALG I.		Institutional moral hazard only exists in the <i>Optionskommunen</i> . This has been addressed through supervision by the regional authorities and quantified target agreements.	
11	Conclusion from 5-6-7: approach to principal-agent issues?	Principal-agent issues exist w.r.t. activation of ALG I caseload and this has been addressed through a system of performance measurement, NPM reforms. The BA is overseen by a tripartite supervisory board.		Principal-agent issues exist w.r.t. activation of the ALG II caseload, specifically concerning the BA and the jobcentres. This has been addressed through a system of performance measurement, monitoring by the Länder and quantified target agreements. Furthermore, the BA is overseen by a tripartite supervisory board.	
12	Contribution to macroeconomic stabilisation by the benefit system	Important (Dolls <i>et al</i>)			

8. Conclusion

Germany has struggled with its division of labour in its regulation of unemployment. Starting from a relatively decentralised system, heterogeneity and institutional moral hazard prompted reforms. These reforms have, in effect, created three types of one-stop shops for the activation of benefit schemes: those for ALG I, those for ALG II and finally the one-stop shops within *Optionskommunen*. The one-stop shops for ALG I are a managerial decentralised feature (with responsibilities delegated to the BA) of the German model and the ones within the *Optionskommunen* are politically decentralised. Nevertheless, most activation is performed by a single actor: the federal PES. However, the federal government did centralise SA and gained more influence over its activation. Therefore, it is possible to argue that Germany has moved away from political decentralisation and towards a more managerial decentralised system.

A move away from political decentralisation towards delegation implies that the issues the federal government is confronted with are best conceptualised as principal-agent issues. The response to the principal-agent issues associated with the BA after the Hartz reforms has been the creation of a performance measurement system, both for UI and for SA. However, there is a crucial difference in the approach to the monitoring of activation of ALG I and ALG II beneficiaries. On one hand, the implementation of activation of ALG I beneficiaries is left almost completely to a self-governing institution, while on the other hand the federal government has gained more influence over activation of ALG II.

Whether this difference in approach is due to a strong reaction to former instances of institutional moral hazard, or whether it is due to the involvement of other levels of government in the governance of ALG II and its one-stop shops is difficult to say. In any case, it is interesting to see that in the face of challenges similar to those in Austria and Switzerland, Germany has opted for a centralising move.

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